In the Supreme Court
OF THE
United States

October Term, 1955

No. 74

United States of America,
Petitioner,
v.
Leslie Salt Co.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF FOR LESLIE SALT CO.

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OPINIONS BELOW

The District Court's opinion is reported at 110 F. Supp. 680. The opinion of the Court of Appeals is reported at 218 F. 2d 91.

JURISDICTION

Jurisdiction is as set forth in the petitioner's brief.

QUESTION PRESENTED

Whether two instruments issued by a borrower to two insurance companies are what they purport to be and as the District Court and Court of Appeals found—promissory notes and not subject to tax—or are said instruments "debentures" or "certificates of indebtedness" and thus subject to tax within the meaning of Section 1801 of the Internal Revenue Code of 1939.

STATUTE AND REGULATIONS INVOLVED

The statute and the present regulations are set forth in the petitioner's brief at pages 2-4.

Additional regulations or administrative material involved are Treasury Decision 2713, 20 Treas. Dec. Int. Rev. 358 (1918), Articles 8, 10, 14, 48, 58, Regulations No. 55, 22 Treas. Dec. Int. Rev. 502 (1920), and L.O. 909, Sales Tax Rulings, December 1920, S.T.-1-20, reproduced as Appendix A, B and C, respectively, to this brief.

STATEMENT

Petitioner's statement consists of a summary of the terms of one of the two notes which were taxed, and the accompanying certificate and loan agreement (Pl. Ex. 1, R. 44, 87; Pl. Ex. 2, R. 44, 90; Pl. Ex. 3, R. 45, 93, respectively). This summary is correct so far as it goes. However, entirely omitted from the petitioner's statement is any discussion of the testimony of the witnesses called, this testimony describing in detail the differences between

"debentures," which are subject to tax, and "promissory notes," such as the Leslie Salt Co. notes, which are not properly subject to tax.

On examination of the whole record, it is apparent that promissory notes on the one hand and debentures on the other have some similarities but that they also have significant differences. The key to the differences lies in the conflicting purpose each instrument is designed to serve. A debenture is designed for public offering and for easy resale if the purchaser so desires. Its terms, appearance and methods of sale are designed to accomplish this result. A non-negotiable promissory note (such as the two involved in the instant case) by its very nature cannot be offered for sale to the general public, nor can such a note be readily resold. Of course it is conceivable that instruments entitled "debentures" could be offered to only one lender and that said instruments could contain all terms customarily appearing in debentures. However, this procedure would be pointless unless the buyer, in turn, contemplated resale to the investing public and wanted to avoid the necessity of retiring an old instrument and the substitution of debentures before making a public offering (R. 72).

The difference in *purpose* between a debenture and promissory note should be kept in mind in evaluating the evidence we now discuss.

First, the method of sale. Leslie Salt Co. (hereafter referred to as Leslie) needed more money and had one of its directors approach the two insurance companies which made the loan (R. 49). No other prospective lenders were approached, and all negotiations were carried on directly

between the two insurance companies and the borrower without the services of an investment banker or other intermediary (R. 49). The two lenders took the initiative in drafting the terms of the loans, the terms were discussed, and the loans were closed in San Francisco (R. 50). By contrast, debentures are prepared to be sold as other corporate securities are sold in that they are designed to be offered to the ultimate buyers through the channels of investment bankers who employ their own distribution facilities (R. 62). The investment bankers act as middlemen in that they use their capital to purchase the issue and then resell to the public (R. 62, 63). The terms involved with respect to debentures are negotiated between the borrower and buying investment banker, or, in the case of competitive bidding, they are fixed solely by the borrower. But so far as the *ultimate* lender is concerned, terms are already fixed and his sole choice is limited to buy or not to buy. The two insurance companies making the Leslie loans were not presented with such a take-it-or-leave-it proposition; here the *lenders* took the initiative in presenting terms—the exact converse of the situation present when buying a debenture.

Although the services of an investment banker may be employed in the private placement of a promissory note, its role is that of a negotiating agent and neither its capital nor its distribution facilities are employed (R. 63). The notes may be placed without the aid of an investment banker at all, which was the case with Leslie (R. 63).

Other characteristics of a debenture sale as contrasted to the sale of a promissory note are (a) a sale of debentures is customarily advertised by an accompanying circu-

lar or prospectus, (b) a prospectus is filed with the Securities and Exchange Commission if the sale is of any size, (c) it is customary to attempt to obtain clearance with various state blue sky law commissions, (d) the underwriters request an opinion of counsel as to the legality of investment by various financial institutions (R. 70-71).

After original sale, debentures are constantly bought and sold and otherwise traded in after original issuance, and public quotations are made as to the going price (R. 69-70). There is no such after-market for notes such as the present ones (R. 70), and the Court will see that the lenders are acquiring the present notes for their own account and not for resale (Pl. Ex. 3, R. 45, 100).

With respect to terms and appearance, a debenture is accompanied by an indenture containing various protective provisions to protect the purchaser, and provision is made for an independent trustee to enforce the rights of the buyers as contained in the indenture (R. 61). The Leslie Salt Co. notes are accompanied by loan agreements which on their face are likewise designed to protect the lenders (Pl. Ex. 3, R. 45, 93). However, no trustee is created. The purpose of a trustee in connection with a debenture issue is that debenture issues are designed to be widely held and traded in, and individual debenture holders are in no position to effectively protect their rights (R. 62). When two informed lenders alone are involved, as is true with the Leslie Salt Co. loans, no trustee is needed. Protective features are usually more severe with respect to notes than for debentures (R. 61). Debenture certificates are prepared in a form to be negotiable and

have the word "debenture" printed on them, or engraved, together with restrictive covenants (R. 72). None of these features appear on the Leslie Salt Co. notes.

As to amount, debentures are usually offered in units of $1,000, or multiples thereof (R. 62). It is self-evident that the relatively small denomination of debentures is again designed to facilitate a wide distribution and easy resale, whereas notes such as the Leslie Salt Co. notes, in the amount of $1,000,000 and $3,000,000, respectively, are too high in price for such purpose.

The District Court made a finding of fact that the two promissory notes were what they purported to be and did not have the characteristics that would make them "debentures" *as said term is commonly defined* (R. 31). Accordingly, it entered judgment for respondent (R. 34-35). The judgment was affirmed by the United States Court of Appeals for the Ninth Circuit on December 16, 1954 (R. 142).

SUMMARY OF ARGUMENT

In February of 1949, the respondent issued two promissory notes in the amount of one and three million dollars, respectively, to two insurance companies, the notes being accompanied by loan agreements. A stamp tax was paid on the notes and this successful suit for refund followed.

The tax was imposed under the purported authority of the Internal Revenue Code of 1939 which assesses a tax of eleven cents a hundred dollars on "bonds, debentures, or certificates of indebtedness issued by any corporation,

and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities." (Italics added).

The words in italics were added by the Revenue Act of 1918. For approximately thirty years, and as conceded in M.T. 32, Cum. Bull. 1948-2, p. 160, petitioner would not have sought to tax notes such as the Leslie notes unless they could be placed within the framework of the 1918 addition, which admittedly does not apply to the Leslie notes.

Petitioner reversed its prior administrative construction about a year and a half before the Leslie notes were executed and contended that similar notes were "debentures," thus provoking the rash of litigation which ultimately prompted this Court to grant certiorari.

Petitioner also now makes the new and subsidiary contention that the Leslie notes are "certificates of indebtedness."

The validity of this changed administrative construction of the statute as applied to the Leslie notes is the issue in the case.

I.

The prior administrative construction was correct and the present interpretation incorrect. For debentures are marketable instruments issued in a series, accompanied by an indenture to which a trustee is a party. None of these features exist with respect to the Leslie promissory notes. Although this Court has never found it necessary to the decision to define the word debentures, its prior usage has been in accord with the above definition. The definition is

also supported by the detailed testimony of an expert witness (R. 51-74), this testimony being uncontradicted.

In opposition, petitioner relies on the definition of debentures as the word is used in England. This definition is irrelevant, as the usage is different in the United States.

Petitioner next relies on partial and incomplete American definitions referring to the similarities of debentures and promissory notes. Petitioner's American authorities are also of no help to this Court. For although promissory notes and debentures are similar in the sense that each contains a promise by the borrower to pay the lender, an instrument containing some of the essentials of a promissory note is not pushed into the classification of debentures unless it has the *additional* characteristics of a debenture such as an accompanying trust indenture.

II.

The trial court's finding of fact that the Leslie notes are not debentures is fortified by a provision in the loan agreement demonstrating in concrete form the differences between the Leslie notes and debentures. The provision in question permits the lenders to insist that the borrower create entirely new instruments to replace the present notes up to the then unpaid balance of the loan. These new instruments are in substance debentures because, unlike the notes now sought to be taxed, they are to be accompanied by a trust indenture and are to be in registered or coupon-bearing form. If and when such debentures are created a tax should be imposed. This provision does not, as contended by petitioner, aid in making the present notes taxable, because the statute taxes documents

already in existence, not hypothetical instruments which may or may not be created in the future.

III.

The legislative history confirms the fact that the Leslie notes are not debentures within the meaning of the statute.

Prior to the Revenue Act of 1918, the statute taxed "bonds, debentures and certificates of indebtedness." According to the administrative construction, whether called bonds, debentures, or notes, an instrument was taxable as a bond if issued in a series, accompanied by a trust indenture, and in registered form or with coupons attached.

This construction was approved by Congress, and in the Revenue Act of 1918 the words "and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities" were added to the statute. The committee reports and debate indicate that no change in substance had been made to the statute, so apparently the words were regarded as descriptive of the class of obligations already taxed, namely, bonds, debentures and certificates of indebtedness, or a "note" if containing the same features.

Promissory notes were taxed prior to 1924 but in a different paragraph of the statute and at a different rate. Regulations No. 55, adopted in 1920, distinguishes "notes" which are in reality bonds or debentures and should be taxed as such, and those to be taxed at the rate applicable to promissory notes. Instruments issued

in a series accompanied by a trust indenture and in registered form or with coupons attached were to be taxed as bonds whether called bonds, debentures or notes. On the other hand, notes which, like the Leslie notes, are not in registered form and do not have coupons were to be taxed at the rate applicable to promissory notes.

The tax on promissory notes was repealed in 1924 and that on bonds and debentures reenacted. In so acting, Congress was aware that the only notes the Treasury regarded as in substance bonds or debentures were those issued serially, accompanied by a trust indenture and in registered or coupon-bearing form, *none* of which features exist in the present case.

Notes not in registered form or with coupons attached continued to be regarded as non-taxable until 1947 when the Government persuaded the Second Circuit that notes in some respects similar to the Leslie notes should be taxed as debentures. That case provoked the present wave of litigation.

IV.

Petitioner also makes the last-minute contention that the present notes are "certificates of indebtedness." This contention was not made in denying the taxpayer's claim for refund or at trial and, although mentioned in passing on appeal, it was not pressed before the court below.

The administrative construction shows that in the past the Treasury has regarded the term "certificates of indebtedness" as being restricted to instruments having the character of "investment securities," which have always been regarded as corporate obligations which can

be bought and sold on the market—unlike the Leslie notes. None of the regulations, past or present, provide support for the present contention.

It is doubtful that the term "certificates of indebtedness" ever added much to the statute, since, as this Court has previously observed, the term is practically synonymous with bonds. In apparent recognition of this fact, Congress dropped certificates of indebtedness as a separate tax classification in the Internal Revenue Code of 1954, the committee reports indicating that no change of substance had been made.

V.

An affirmance here is supported by the great weight of authority below. Six factually similar cases have been won by the taxpayer before the appellate courts; only one appellate case which cannot be distinguished has been won by the petitioner, and that case relied on unnecessarily expansive language of a Second Circuit decision which has since been repudiated by the same court.

ARGUMENT.

1. THE EVIDENCE IN THIS CASE SUPPORTS THE PRIOR ADMINISTRATIVE CONSTRUCTION THAT THE LESLIE NOTES ARE NOT "DEBENTURES" AS THE WORD IS COMMONLY DEFINED AND ARE CONSEQUENTLY FREE FROM TAX.

To place this case in proper perspective, we should first note that in the past a stamp tax has been imposed on both "debentures" and "promissory notes" but always in different paragraphs of the statute and at different rates. The tax on notes was repealed in 1924. Conse-

quently, since petitioner cannot tax the Leslie notes as "promissory notes" it now contends they must be "debentures." However, in making this contention petitioner has reversed an administrative construction of some thirty years duration, as we point out in detail in Section Three of this brief. For although bonds, debentures and promissory notes are somewhat similar in that each contains a promise by the borrower to pay the lender, they have significant differences. Debentures have, in form, some of the qualities of promissory notes, as recognized by the authorities petitioner cites (Br. 20-25). However, although containing some of the essentials of a promissory note, such "notes" are pushed into the tax classification of bonds or debentures according to the past Treasury practice *only* if issued in a series, accompanied by an indenture to which a trustee is a party, and containing a provision for registration or with coupons attached. For approximately thirty years petitioner would not have regarded the Leslie notes as taxable as they lack *all* the foregoing features. The reversal in administrative construction came not because the definition of "debentures" has become expanded in financial usage or that of "promissory notes" contracted, not because Congress has amended the statute; it came solely because for a short period petitioner received some judicial support for an approach which concentrates on the similarity of promissory notes and debentures while wholly ignoring their differences.

The prior and contemporaneous administrative construction is of particular weight, since Congress on several occasions reenacted the statute taxing debentures and

certificates of indebtedness without significant change while that construction was still in effect. It was still in effect at the time of adoption of the Internal Revenue Code of 1939 under which petitioner attempts to apply the tax in this case. The *only* reenactment of the statute after petitioner changed its administrative construction occurred after the trial of this case with the passage of the Internal Revenue Code of 1954. Then, although Congress knew the administrative practice had been changed, it also knew that that change was being resisted, and for the most part successfully so, by taxpayers in the lower courts.

That the prior administrative construction was correct and the differences in the types of documents significant, rather than of no importance, is further confirmed by the uncontradicted evidence received in this case and by the authorities. In evaluating that evidence, we accept as axiomatic that the ordinary meaning of the term "debentures" was intended in the statute, and that this Court will adhere to its prior holding in *United States v. Isham*, 17 Wall. 496, 504, 21 L. Ed. 728 (1873), where, in referring to the stamp tax statute, the Court stated:

> "The words of the statute are to be taken in the sense in which they will be understood by that public in which they are to take effect."

The testimony below establishes the sense of the word "debentures" as the term is used and understood in the business and financial world which is the source of the tax. The usage, as brought out by the evidence, is confined to instruments which have qualities designed to permit their ready marketability. In contrast, the Leslie

notes are not marketable. Instead, their large size and lengthy duration[1]—the factors petitioner seizes upon in contending them to be debentures—are some of the principal factors which obviously prevent their marketability, which is the classic and essential feature of debentures.

Since the evidence has already been reviewed in some detail in our "Statement", we merely summarize at this point some of the principal features which set the Leslie notes in a class apart from debentures. Although two notes are involved, since they are identical except for amount and payee (R. 85) only one is included in the printed record. (Pl. Ex. 1, R. 44, 87). That note and the accompanying loan agreement (Pl. Ex. 3, R. 45, 93) and certificate (Pl. Ex. 2, R. 44, 90) differ from a debenture in important and essential respects, as follows:

1. *Terms.* There is no accompanying indenture, no provision for a trustee (R. 61), and the note is not prepared in a form to be negotiable (R. 33, 72).

2. *Mode of Sale.* The notes were the final result of prior negotiations directly between borrower and lender and no others (R. 49), and were not sold or designed to be sold to the investment public or the highest bidder (R. 62). The note was not designed for trading after original issuance and there is no after market for the note (R. 69). No investment banker or underwriter was involved, even as a negotiating agent (R. 49, 62-63, 70).

3. *Appearance.* Although of less importance, we do not find the word "debenture" printed or engraved on the note, nor any restrictive covenants

[1]One and three million dollars, respectively, each for fifteen years.

on its face (R. 72), the note being on plain white paper.

The business necessity for the provisions setting debentures apart from the Leslie notes is that a member of the buying public, typically buying a debenture through the channels of investment bankers and investment banker groups, does not negotiate at all as to terms—his sole choice is to buy or refuse to buy. And his choice is likely to be not to buy unless the debenture is in a form, as it invariably is, to permit easy resale, and the purchaser has the added protection of a trustee who will enforce the rights of all holders.

Although this Court has never found it necessary to the decision to define debentures, its usage of the term, so far as we can determine, has been confined to instruments having the same marketable characteristics deemed vital according to the evidence received in the record in this case and the prior administrative construction as mentioned above. Thus, in *First Nat. Bank v. Flershem*, 290 U.S. 504, 508, 511-512, 78 L. Ed. 465, 65 S. Ct. 292 (1934), Mr. Justice Brandeis, writing for the Court, uses the term "debentures" in referring to an issue which had been marketed by underwriters, was accompanied by an indenture to which a trustee was a party, and which had coupons attached.

The foregoing usage by this Court was nothing new. For in this country the attributes of "debentures" as the term is employed in *First Nat. Bank v. Flershem*, *supra*, existed since the early years of the century and prior, it should be noted, to the repeal in 1924 of the tax on promissory notes. Thus, in a paper entitled

"Preparation of Corporate Bonds, Mortgages, Collateral Trusts, and Debenture Indentures," by F. L. Stetson presented in 1916, which is contained in *Some Legal Phases of Corporate Financing, Reorganization and Regulation*[2], the author states:

> "In the United States, as already mentioned, the term 'debenture' is understood to mean *serial obligations* of a corporation not secured by a specific mortgage, pledge or assignment of property. Of course *a series* of debentures may be issued without the execution of any indenture relating thereto. *Prior to 1900 the few issues that had been made of such debentures were not accompanied by a trust agreement.* In such case the right and privileges given to bondholders were set forth at length in the obligation, thus making a somewhat lengthy instrument. *Since an issue of debentures under trust agreements by the Lake Shore R. R. Co. and by the New York Central, the custom of adopting such agreements has become general.* Originally in 1893 the General Electric Company made a large issue of debentures without an agreement, but at the time of the refunding in 1912 a trust agreement was executed" (p. 66). (Italics added.)

It thus appears that as early as 1916 debentures were regarded as instruments issued in a *series* accompanied by a trust indenture.[3]

[2]This work contains a series of lectures given before the Association of the Bar of the City of New York in 1916. It was reprinted in 1930.

[3]Petitioner claims (Br. 30) that a single debenture can be issued to a single person, citing *Keeley v. Associated Gas & Electric Co.*, 155 Misc. 146, 278 N.Y.S. 962 (1935), a case which was apparently misread since it deals with *suit* on a single debenture, and there is no indication whatsoever that that debenture

The fact that debentures are designed to be bought and sold and otherwise traded has also been relied on by the lower courts in the present type of litigation in rejecting the Government's attempts to impose a tax on notes similar to the Leslie notes, e.g., *Niles-Bement-Pond Co. v. Fitzpatrick*, 213 F.2d 305, 311 (2d Cir. 1954); *Atlanta Metallic Casket Co. v. Allen*, 99 F. Supp. 104, 106 (M.D. Ga. 1951), aff'd, 197 F.2d 460 (5th Cir. 1952) (also an insurance company case).

So far as the opinions in the reported cases disclose, petitioner has never been able to call a witness to present evidence concerning the characteristics of debentures which would support the all-encompassing definition petitioner has recently coined for purposes of this type of litigation. Therefore, to counter our position the petitioner employs two devices, neither of which has any foundation in the record or the language or history of the statute.

First, petitioner cites a series of English authorities. This is done despite the admonition in *United States v. Isham*, 17 Wall. 496, that the words of the statute are to be construed according to the understanding of the business and financial community in which it is to take effect. Even without this admonition, the common sense of the matter is that Congress intended the word "de-

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(in the amount of $2,000) was not one of a series. On the contrary, since the same utility was involved in other litigation with other debenture holders, e.g., *Fitzpatrick v. Associated Gas & Electric Co.*, 148 Misc. 538, 266 N.Y.S. 116 (1933) and *Emerson v. Associated Gas & Electric Co.*, 148 Misc. 636, 266 N.Y.S. 265 (1933), it seems a certainty that the *Keeley* debenture was part of a series. Petitioner's contention that debentures need not be issued in a series is thus without support in either the record or the American cases.

bentures" to be understood in accordance with the usage here in the United States, not that employed in the English Chancery Division. Petitioner's authorities are irrelevant.

Second, petitioner cites authorities which, in giving a partial definition of "debentures", comment on the similarities of debentures to promissory notes. Of course there are similarities, in the sense that every bond, debenture or promissory note contains a promise by the borrower to pay the lender. That does not mean that all three instruments somehow become debentures. For there are also significant differences as brought out without dispute by the evidence in this case.

The Leslie notes are not debentures by any ordinary and complete definition which has found acceptance as the word is used in this country. In urging that this Court accept the novel and all-embracing definition now fabricated for this case, the United States also impliedly urges a reversal of the Court's holding in *United States v. Isham*, 17 Wall. 496, 504, ignores its prior administrative construction of the statute, and exhorts this Court to invade a field occupied by Congress in extending the reach of the tax to instruments not included within the statute by any common understanding or meaning of its terms.

Further, in urging that this Court adopt the definition now coined, which includes virtually any promise to pay, petitioner's argument proves too much. For Congress always recognized that there were differences between promissory notes and debentures by taxing them in different paragraphs of the statute and at different rates. In

addition, Congress recognized, as we later point out, that certain instruments entitled "notes" were in substance bonds, debentures or certificates of indebtedness. To tax such documents it added a phrase to the statute in 1918 to tax such instruments at the rate applicable to bonds or debentures if the instrument was in registered or in coupon-bearing form. By rendering meaningless this 1918 addition in urging a tax on the Leslie notes despite the fact they are not in registered or coupon-bearing form, petitioner's argument violates all known canons of statutory construction, for acceptance of the argument makes nugatory the 1918 addition to the statute rather than giving effect to every word.

In the past, this Court has frequently stated that a tax statute will not be extended by implication and should be construed in favor of the taxpayer. We believe this position was correct. But whether or not it be adhered to now, whether the presumption be for or against the taxpayer, the Leslie notes do not somehow become debentures simply because it now seems wise or desirable to petitioner that they be taxed.

The court below demonstrated that it had a correct appreciation of its role and that of this Court when it stated, 218 F.2d at page 92 (R. 139):

> "It is altogether likely that had Congress foreseen the development of corporate financing by means of large long-term placement loans like these it would not have repealed outright the statutory tax it had imposed during the first World War on promissory notes, but would have modified the statute to conform with the development. Congress has since had abundant opportunity to legislate on the subject but

has not seen fit to do so. We can not but feel that in the considerable number of instances where courts have upheld exactions of the tax in situations analogous to the present they have invaded a field belonging exclusively to Congress."

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2. THE PRESENCE OF THE PROVISION PERMITTING SUBSTITUTION OF MARKETABLE OBLIGATIONS FOR THE EXISTING NOTES POINTS UP THE DIFFERENCES BETWEEN SAID NOTES AND DEBENTURES.

The loan agreement contains a provision (Pl. Ex. 3, Sections 4.2, 4.3, R. 45, 100-102) permitting the lender, at its election, to require the substitution of what are in substance debentures for the existing notes. By a curious process of inverted reasoning, petitioner contends (Br. 13, 29) that this provision shows that the original notes have the same character as the successor debentures. If this were so, why have the provision? Why go to the trouble of permitting substitution and the expense of preparation of a new series of instruments if nothing has been accomplished? The fact is that the original notes, in contrast to debentures, are in such form and denomination that they cannot readily be marketed. The necessity for the wholly different form of the new documents points up the distinction between the notes now sought to be taxed and the instruments Congress intended to tax.

Petitioner's logic is equally at fault when it contends that such a provision makes the original instrument "marketable" when the whole purpose of the provision is to substitute new obligations which *are* marketable for the old which are not.

We concede that if and when debentures are substituted for the old notes a tax should be imposed. That is not to say, however, that a tax should likewise be imposed on the old notes. For Congress was concerned with taxing instruments already in existence, not hypothetical instruments which may or may not come into existence in the future.

It should also be noted that petitioner has been unable to point to any evidence in the record or even any textbook authority, so heavily relied on elsewhere, that indicates that such a provision makes a note a debenture or otherwise taxable. Indeed, the testimony in the case indicates that a promissory note retains its character whether or not such a common provision is included (R. 69). It is submitted that the trial court's finding of fact (R. 30-31) that the two notes are not debentures is not weakened but clearly supported by the presence of the clauses in question which highlight in concrete form the essential differences between debentures and the Leslie notes.

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3. THE LEGISLATIVE HISTORY IN THE SETTING OF THE ADMINISTRATIVE CONSTRUCTION DEMONSTRATES THAT THE LESLIE NOTES ARE NOT TAXABLE.

Significantly absent from the Government's brief is any discussion of the administrative construction of the pertinent statute in its various forms. Yet, as conceded in M. T. 32, Cum. Bull. 1948-2, page 160, for a period of approximately thirty years the "long and uniform holding" of the Treasury was that notes such as those here involved are non-taxable. This administrative construc-

tion was spelled out in detail for years prior to the time of repeal of the tax on promissory notes, and in adopting the 1924 repealer of the promissory note tax while reenacting the tax on bonds and debentures Congress acted in the full knowledge that in accordance with that construction the tax would still apply only to marketable obligations of a character distinct from the notes now before this Court.

Once placed in the proper setting of the administrative construction, the legislative history establishes that the two courts below reached a correct result, as we shall demonstrate.

The first statute of significance for purposes of the present problem is the Revenue Act of 1917 (40 Stat. 300). Section 807 (p. 321) imposed a tax on "Bonds, debentures or certificates of indebtedness issued after the first day of December, 1917, by any person, corporation, partnership or association * * *." Promissory notes were taxed at a different rate under paragraph 6 of schedule A (p. 323).

In Treasury Decision 2713, May 14, 1918, 20 Treas. Dec. Int. Rev. 358 (1918)[1], a distinction was drawn between a bond and a promissory note for purposes of taxation, the Treasury Department concluding that some "notes" would be taxed at the rate applicable to bonds and debentures, the notes to be so taxed being described as follows:

> (2) Instruments containing the essential features of a promissory note, but issued by corporations in

[1] Reproduced in full as Appendix A to this brief.

numbers under a trust indenture, either in registered form or with coupons attached, embodying provisions for acceleration of maturity in the event of any default by the obligor, for optional registration in the case of bearer bonds, for authentication by the trustee, and sometimes for redemption before maturity, or similar provisions, are bonds within the meaning of the statute, whether called bonds, debentures, or notes. However, a short-term instrument, although issued by a corporation under a trust indenture, may be regarded as a note if every instrument of such issue both (a) is payable to bearer and incapable of registration and (b) lacks interest coupons and so requires presentation upon each payment of interest."

Although arbitrarily classifying the instruments referred to above as "bonds" for purposes of the tax, the definition applies equally to "debentures" which, in the same decision, the Treasury defines as "ordinarily" an unsecured bond.

The above administrative construction received express Congressional acceptance. In Schedule A, Title XI of the Revenue Act of 1918, 40 Stat. 1057, the debenture section was amended (p. 1135) to provide:

"Bonds of Indebtedness: On all bonds, debentures, or certificates of indebtedness issued by any person, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities, ..."

Section 1 of the Act (p. 1057) defined "person" to include corporations.

Judging from the contents of the committee reports[5] and the debate[6], Congress appears to have been of the opinion that no change in substance had been achieved by the added phrase, so that it seems likely that the 1918 addition was deemed merely descriptive of corporate obligations already taxed rather than adding new instruments to be taxed. This view was accepted by the Third Circuit which held, in *Bellefield Co. v. Heiner*, 25 F.2d 560, 562 (3d Cir. 1928):

> "Turning to the quoted provision of the Revenue Act for guidance, we find a more or less complete definition of taxable instruments under the heading of bonds, the critical parts being that an instrument

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[5]H.R. Reports Nos. 767 and 1037, and S. Report No. 617 on H.R. 12863 (65th Cong., 2d and 3d Sess.).

[6]See, for example, the following statements:

In the debate on H.R. 12863, Congressman Dixon stated (56 Cong. Rec., Part 10, p. 10,202):

> "The stamp taxes provided for in this bill simply re-enact the existing law, . . ."

Congressman Cannon said simply (56 Cong. Rec., Part 10, page 10,245:

> "The present stamp-tax law is re-enacted . . ."

To similar effect are the following:

(1) *56 Cong. Rec., Part 10, p. 10,469:*

"Mr. Walsh. Mr. Chairman, is this [relating to Title XI—Stamp Taxes] the title of the bill in which there is but one change in the tax?

"Mr. Kitchin. One change in the stamp tax on playing cards, . . ."

(2) *56 Cong. Rec. Appendix, Part 12, p. 641:*

[Congressman Hull] "The list of special taxes embraced in the bill is very similar to the system of special taxes found in the Civil War Revenue Act. The same may be said of the stamp taxes in the present law and which are re-enacted in the proposed bill."

(3) *56 Cong. Rec. Appendix, Part 12, p. 699:*

[Congressman Kitchin] "The next [title] is Title XI. That is the stamp tax. It is exactly as it is in the present law . . ."

taxable as a bond must be issued with interest coupons or in registered form."

In 1920, the Treasury further clarified the distinction between "notes" which in reality have the characteristics of bonds or debentures and promissory notes such as those now involved (Pl. Ex. No. 1, R. 44, 87) which were to be taxed at the lower rate applicable to promissory notes. Regulations No. 55, October 26, 1920, 22 Treas. Dec. Int. Rev. 502 (1920).[7]

The two significant provisions were as follows:

"ART. 8. Instruments issued by corporations in numbers, under a trust indenture, are bonds.—Instruments containing the essential features of a promissory note, but issued by corporations in series, secured by a trust indenture, either in registered form or with coupons attached, embodying provisions for acceleration of maturity in the event of any default by the obligor, for optional registration in the case of bearer bonds, for authentication by the trustee, and in some instances for redemption before maturity, or similar provisions, are bonds within the meaning of the statute, whether called bonds, debentures, or notes."

* * * * *

"ART. 48. 'Promissory notes'.—(a) A promissory note is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand or at a fixed or determinable future time a sum certain in money to such other person, or to order or to bearer, free from restrictions as to registration or transfer, and usually without coupons."

[7] All pertinent provisions are reproduced as Appendix B to this brief.

The Leslie Salt notes clearly come within the last-quoted definition and escape the former. Although the definition employs the word "person", the corporate note is also included since "person" is defined in the Revenue Act of 1918 (Section 1) to include corporations as well as individuals. Also, the Leslie notes are expressly made free from restrictions on transfer (Pl. Ex. No. 3, Section 4.1, R. 45, 100), and are not registered nor do they have attached coupons (R. 31).

It should be noted that once the Treasury issued a formal regulation it retreated from an earlier view, which it had adhered to for only two years, in T. D. 2713, *supra*, that a promissory note was "such as is common in everyday commercial use." No such restriction appears in Article 48. Further, the Treasury was clearly correct in placing a less restrictive construction on the term "promissory notes." For a promissory note does not become a bond, a debenture, or a certificate of indebtedness because in elaborate form anymore than a fifty-year, highly detailed lease somehow becomes a deed. As said in *Belden Mfg. Co. v. Jarecki*, 192 F.2d 211, 214 (7th Cir. 1951):

> "Neither are we impressed with the argument that because certain provisions contained in the application are the same as or similar to those ordinarily found in a debenture, they require that it be characterized as such. Even if such be the case, such provisions are equally compatible with the theory that the instrument in question was a note. Defendant lays much stress upon the fact that the loan was for a large amount and for a long period. Defendant states in his brief, "by the issuing of this instru-

ment, taxpayer obtained working capital of $1,000,000 for a substantial period of time, just as it might have done by the sale of its bonds, debentures or similar securities'. This may be a circumstance but, if so, it is of minor consequence. We do not think a note changes its character because it is for $1,000,000 rather than for a lesser amount, nor because it is payable over a period of five years rather than over a shorter time."

The foregoing definitions were promulgated anew in 1922. Regulations No. 55, June 12, 1922, 24 Treas. Dec. Int. Rev. 895 (1922).

Congress, of course, reenacted the tax on bonds and debentures but repealed the tax on promissory notes in 1924, and notes have not subsequently been taxed. Revenue Act of 1924, 43 Stat. 253, Schedule A, Title VIII.

With the prior administrative interpretation before us, we need not speculate or guess as to what Congress had in mind in adopting the 1924 repealer, for by that time the formally enacted regulations had for a period of some years duration made clear that the only instruments entitled "promissory notes" which were and would continue to be taxed as bonds or debentures were those issued in a series, accompanied by a trust indenture, and is registered as coupon-bearing form. On the other hand, the definition of the "promissory notes," upon which the tax was repealed, was quite broad. The Treasury had added no restrictions as to duration, amount, character of borrower or lender, or purpose of the loan; unless an instrument had the marketable characteristics of debentures previously discussed, Congress knew in re-

pealing the tax that under the Treasury practice no tax would be imposed. Indeed, this was exactly what happened for a period of in excess of twenty years and until the Government's unexpected success in *General Motors Acceptance Corp. v. Higgins*, 161 F.2d 539 (2d Cir. 1947), the case which produced the rash of litigation which prompted this Court to grant certiorari in the present action.

Under the circumstances, the petitioner's argument to the effect that the only note relieved of tax was the simple I.O.U. does not rise even to the dignity of a make-weight. The entire argument rests on a few scattered comments of various Congressmen in a highly political setting, *wholly* ignores the administrative history of the statute, and flies in the face of the concession made elsewhere that Congress was aware that corporations were paying the bulk of the promissory note tax as a result of large loans (Br. 38).

It required no clairvoyance by Congress to foresee that some corporations would borrow large sums for lengthy periods on promissory notes with detailed restrictions and still avoid tax. This result was inevitable under the then administrative construction of the statute. We concede that the aggregate amount of such borrowing has, as contended by petitioner (Br. 39), probably exceeded expectation. But this contention should be addressed to Congress in an effort to amend the statute. A tax-free note does not become a taxable debenture merely because the use of such notes is on the increase.

It should perhaps be added that we should not be understood as implying that the Leslie notes must neces-

sarily be "promissory notes" as defined by the Treasury in 1924 to avoid tax. We submit they are. But even were this Court to reject our contention, the Government is no better off unless it affirmatively establishes that the instruments in question are debentures. See, Judge (now Mr. Justice) Harlan's comments in this connection in *Niles-Bement-Pond Co. v. Fitzpatrick*, 213 F.2d 305, 308 (1954).

And in determining whether the instant notes affirmatively appear to be debentures, this Court does not have before it a statute of broad and far-reaching significance intended to embrace virtually any type of transaction as contended by petitioner (Br. 29-30). Instead, as the pre-1924 administrative and legislative history makes clear, the only instruments purporting to be promissory notes which Congress still intended to tax were those which had the same characteristics as bonds or debentures, namely, accompanied by a trust indenture and in registered form or with coupons attached. This was the purpose of the 1918 addition to the statute, which clarified the law, as recognized by the Treasury itself. Thus, in L. O. 909, Sales Tax Rulings, December 1920, S.T.-1-20[8], the Solicitor of Internal Revenue states:

> "The words 'all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities', were clearly added in recognition of the varied forms in which corporate securities are issued, and to defeat any attempt to avoid the tax by issuing instruments of the *general character of bonds, deben-*

[8]Reproduced in full as Appendix C to this brief.

tures, or certificates of indebtedness under a different name." (Italics added.)

But the *only* instruments bearing a name other than bonds, debentures, etc., which are taxed, according to the statute, are those of the same general character in that they bear coupons or are in registered form. Petitioner now seeks to go beyond the terms of the statute and tax notes such as the Leslie notes simply because they are for a large amount and a lengthy duration despite the fact that they do not bear coupons and are not in registered form. Petitioner's argument, of course, if accepted would render meaningless the words of the 1918 addition to the statute, and for this reason must be rejected. As stated in *Ex Parte Public Bank*, 278 U.S. 101, 104, 73 L. Ed. 202, 49 S. Ct. 43 (1928):

> "No rule of statutory construction has been more definitely stated or more often repeated than the cardinal rule that 'significance and effect shall, if possible, be accorded to every word. As early as in Bacon's Abridgment, sect. 2, it was said that "a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant." ' "

On this point, the subsequent history of the statute is also illuminating.

In the Revenue Act of 1926, 44 Stat. 9, Schedule A, Title VIII, the word "corporation" was substituted for "person" in the first section (p. 101).

Shortly thereafter, a new regulation again defining terms was promulgated. Regulations 71, July 13, 1926, 28 Treas. Dec. Int. Rev. 313 (1926). Article 12 thereof

again defined documents purporting to be promissory notes which would be taxed as bonds or debentures, and no attempt was made to expand the scope of the prior definition in Regulations No. 55 despite the fact that the tax on promissory notes had then been repealed.

In 1939, the title of the first section was changed from "Bonds of Indebtedness" to "Corporate Securities" (Section 1801, Internal Revenue Code of 1939, 53 Stat. 195) so that Section 1801 read as follows:

> "Corporate Securities. On all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities, ..."

The above version of the statute is the one under which petitioner seeks to impose the present tax. At the time of passage it should be noted, under Regulations 71 the Government would still not have sought to impose a tax on the Leslie notes unless they were in registered form or had coupons attached, according to the concession in M. T. 32, Cum. Bull. 1948-2, p. 160.

In 1941, Regulations 71 was amended and took the form it has today. Nevertheless, the administrative construction of the statute and regulations for the succeeding six years left the Leslie notes free from tax.

The turning point came in 1947 with the Government's victory in *General Motors Acceptance Corp. v. Higgins*, 161 F.2d 593 (2d Cir. 1947), *cert. denied*, 332 U.S. 810, 92 L.Ed. 387, 68 S. Ct. 111 (1947).

Before the lower court, judging from the contents of the opinion, the Government took the position that the notes involved, representing large corporate borrowing and accompanied by elaborate protective provisions, were in registered form and consequently taxable. If this contention was sound, the notes were taxable under the prior administrative practice, but the argument was rejected. *General Motors Acceptance Corporation v. Higgins*, 60 F. Supp. 979, 984 (S.D.N.Y. 1945).

On appeal, and apparently for the first time, the Government jettisoned the prior administrative construction and contended the instruments were debentures. This contention was accepted by the Second Circuit in an opinion which discloses that the court completely misunderstood the nature of debentures and in language so expansive that the Bureau of Internal Revenue was encouraged to start its present campaign to tax promissory notes such as those now before this Court.

Since even the *GMAC* notes, much more characteristic of debenture financing than the Leslie notes, as we later point out, would not have been held taxable under the Bureau's practice prior to 1947, in recognition of the radical nature of its departure from the "long and uniform" practice it had adhered to before the Bureau did not apply the *General Motors* case retroactively. Its new position was published shortly after the case came down and is reported in M.T. 32, Cum. Bull. 1948-2, p. 160. We quote in full the significant portion of said ruling, as follows:

"*The Bureau has for a considerable period of time held that an instrument termed 'note', not in*

registered form and issued without interest coupons, is not subject to the stamp tax upon issuance or transfer. Because of this *long and uniform holding* of the Bureau and the consequent reliance of corporations on these rulings, it has been concluded that, under the authority contained in section 1(b) of the Internal Revenue Code, the decision in *General Motors Acceptance Corporation v. Higgins, supra*, will not be applied retroactively, except that any tax which has been paid on the issuance or transfer of instruments falling within the scope of the decision will not be refunded." (Italics added.)

At the outset of its campaign, as a result of the confusion engendered by the *General Motors* case the Bureau was able to persuade a District Court in Maryland to follow its views. *Commercial Credit Co. v. Hofferbert*, 93 F. Supp. 562 (D. Md. 1950). In so doing, however, the District Court followed the erroneous reasoning of the *General Motors* case, apparently without independent analysis. This decision was affirmed by the Fourth Circuit in a per curiam opinion, 188 F.2d 574, again without independent analysis. Since this decision was reached, however, and on more mature consideration, the Courts of Appeal for six circuits, counting the decision below, have taken a second look at the Bureau's attempted rewriting of the statute and have refused to sustain its position, which is how the matter stands at present.

It was, it should be emphasized, only from the dubious vantage-point of in excess of twenty years hindsight that petitioner suddenly decided that the legislative history of the statute was such that promissory notes such as the Leslie notes were somehow debentures or certificates

of indebtedness. As conceded in M. T. 32, Cum. Bull. 1948-2, p. 160, the *contemporaneous*[9] construction of the statute in the setting of its history would have resulted in a Treasury decision that the instant notes are non-taxable. This interpretation existed both before and after the date of publication of Treasury Regulations 71 (1941 ed.), relied on by petitioner. We consequently submit that this Court should follow the earlier and correct administrative construction of the statute and should reject the Bureau's belated and short-lived attempt to rewrite the statute which controls the decision in the case at bar. See, *Jones v. Liberty Glass Co.*, 332 U.S. 524, 533-534, 92 L.Ed. 142, 68 S. Ct. 229 (1947).

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4. THE PETITIONER'S WHOLLY NEW ARGUMENT THAT THE LESLIE NOTES ARE "CERTIFICATES OF INDEBTEDNESS" IS LIKEWISE AT WAR WITH THE LEGISLATIVE AND ADMINISTRATIVE HISTORY.

Petitioner now states (Br. 32-34) that the Leslie notes are "certificates of indebtedness" despite the fact that the Commissioner made no such contention in denying the claim for refund (Pl. Ex. 7, R. 61, 137), nor was it made at trial (R. 57) or pressed before the Court of Appeals, as demonstrated by the failure of the opinion to mention the contention.

It is apparent that petitioner now deems it prudent to seek refuge in the comforting vagueness of the phrase "certificates of indebtedness" solely because so many

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[9] Clearly the construction entitled to greatest if not controlling weight. *Norwegian Nitrogen Co. v. United States*, 288 U.S. 294, 315, 77 L.Ed. 796, 53 S.Ct. 350 (1933).

courts have expressly rejected its primary contention that notes such as the Leslie notes are "debentures."

However vague the term may be, however, it is not sufficiently broad to embrace the Leslie notes as the legislative and administrative history make clear.

In Treasury Decision 2713, May 14, 1918, 20 Treas. Dec. Int. Rev. 358 (1918), it is stated:

> "A 'certificate of indebtedness' is primarily any instrument acknowledging liability for the payment of money, not in the recognized form of a promissory note or bill of exchange."

This definition was considered too broad, and in 1920 an opinion of the Solicitor of Internal Revenue was published recommending that T. D. 2713 should be modified so that only instruments having the character of "investment securities" would be included in the phrase "certificates of indebtedness." L. O., 909, Sales Tax Bulletin, December 1920, S.T.-1-20, p. 84[10]. It is of interest that the Solicitor was aided by the citation of a decision of this Court, *Denver v. Home Savings Bank*, 236 U.S. 101, 105 (1914), stating that it is difficult to see any distinction between bonds and certificates of indebtedness as the two are known in the business world.

Following the foregoing opinion, Article 14 of Regulations 55, October 26, 1920, 22 Treas. Dec. Int. Rev. 502 (1920), defined certificates of indebtedness as follows:

> "The term 'certificates of indebtedness' includes only instruments having the general character of *investment securities* as distinguished from instru-

[10] This opinion is reproduced as Appendix C to this brief.

ments evidencing debts arising in ordinary transactions between individuals." (Italics added.)

As pointed out in *Niles-Bement-Pond Co. v. Fitzpatrick*, 213 F.2d 305, 311 (2d Cir. 1954), the classic feature of "investment securities" is ready marketability, which is emphatically not the case with the Leslie notes. This usage is of long duration, as made clear from the opinion in *Robotham v. Prudential Ins. Co.*, 64 N.J. Eq. 673, 686, 53 Atl. 842, 847 (1903), where the court distinguishes a loan by an insurance company to a corporation directly on the corporation's promissory note, as was done in the Leslie case and in 1903 was illegal in New Jersey, and purchasing investment securities, the court saying in the latter connection:

> "The safe and natural construction of this law, in my opinion, confines the investment of insurance funds, so far as they may be invested in the stock and evidences of indebtedness of private corporations, to such stock or obligations *as may be bought on the market*, and are commonly referred to as 'investment securities'." (Italics added.)

This usage of the term is further confirmed by the language of the McFadden-Pepper Act, 44 Stat. 1224, dealing with permitted investments for national banks, the statute saying in this connection (p. 1227):

> "[T]he business of buying and selling investment securities shall hereafter be limited to buying and selling without recourse *marketable obligations* evidencing indebtedness of any person, co-partnership, association, or corporation, in the form of bonds, notes and/or debentures, *commonly known as investment securities*, under such further definition of the

term 'investment securities' as may by regulation be prescribed by the Comptroller of the Currency * * *." (Italics added.)

The definition of certificates of indebtedness as "investment securities" contained in the regulations remained without change until 1941 when the regulations (Regulations 71, 1941 ed.) merely provided that instruments having the essential nature of bonds, debentures, or certificates of indebtedness would be taxable as such. This change hardly indicates an intention to abandon the requirement that certificates of indebtedness must qualify as investment securities since this is their "essential nature", and this apparently was the view of the Treasury which conceded in M. T. 32, Cum. Bull. 1948-2, p. 160 that notes such as the Leslie notes were not taxable prior to the *General Motors* decision. They would, of course, have been taxable prior to that case if regarded as "certificates of indebtedness" under Regulations 71 (1941 ed.), which remains unchanged to this day.

Indeed, it seems doubtful that the term "certificates of indebtedness" ever added anythi g to the statute, except to tax instruments which were in substance bonds although labelled "certificates of indebtedness" by the issuer, being, as this Court points out in *Denver v. Home Savings Bank, supra,* practically synonymous with bonds. This view appears to be shared by Congress since certificates of indebtedness have been dropped as a separate classification, the sole remaining use of the term being a generic one to embrace bonds, debentures and coupon-bearing or registered notes. In this connection, Section 4381 of the Internal Revenue Code of 1954, 68A Stat., Ch. 34, now provides:

> "SEC. 4381. DEFINITIONS.
>
> (a) *Certificates of Indebtedness.*—For purposes of the taxes imposed by sections 4311 and 4331, the term 'certificates of indebtedness' means bonds and debentures; and also includes all instruments, however termed, issued by a corporation with interest coupons or in registered form, known generally as corporate securities."

In dropping certificates of indebtedness as a separate classification, it is also of interest that from the contents of the committee reports Congress assumed it had made no change of substance[11].

So far as the lower court decisions are concerned, although petitioner is unable to point to a single appellate decision that holds that notes in any way similar to the Leslie notes are "certificates of indebtedness" it purports to take some comfort (Br. 34) in the fact that, at least, only one Court of Appeals has found it necessary to expressly rule to the contrary. *General Motors Acceptance Corporation v. Higgins*, 161 F.2d 593, 595 (2d Cir. 1947). All this proves is that apparently petitioner lacked the temerity to make this patently erroneous contention before any of the six United States Courts of Appeal which have rejected its views that notes similar to the Leslie notes are debentures. Certainly this was the origin of the failure to refer to "certificates of indebtedness" in either of the opinions filed in the present case. Nevertheless, each of said six decisions implicitly ruled that instruments such as the Leslie notes are not "certificates

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[11] S. Rept. 1622, 83d Cong., 2d Sess. (1954), at p. 482; H. Rept. 1337, 83d Cong., 2d Sess. (1954), at p. A324.

of indebtedness" in that each court held them non-taxable under Section 1801 of the Internal Revenue Code of 1939 which embraces the term.

Even assuming, which to us seems erroneous, that at this late date petitioner should be allowed to make this contention, petitioner's last-minute argument cannot be squared with the history and words of the statute, the language of the regulations, or the weight of authority.

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5. AN AFFIRMANCE HERE IS SUPPORTED BY THE GREAT WEIGHT OF AUTHORITY ON THE POINT BELOW.

The decisions below fall into two categories which, for convenience, we will refer to as the "*GMAC* group" and the "*Leslie* group."

The line of demarcation comes best into focus by examining two decisions by the same court, *General Motors Acceptance Corp. v. Higgins*, 161 F.2d 593 (2d Cir. 1947), *cert. denied*, 332 U.S. 810, 92 L. Ed. 387, 68 S. Ct. 111 (1947), where the decision was for the Government, and *Niles-Bement-Pond Co. v. Fitzpatrick*, 213 F.2d 305 (2d Cir. 1954), where the decision was for the taxpayer, the court rejecting some of its earlier language in the *General Motors* case.

Although we repeat, to some extent, the discussion of the *General Motors* case contained in our brief in opposition to the petition for certiorari, for the convenience of the Court we note again at this point that in that case, heavily relied on here, and the decision which persuaded the Bureau of Internal Revenue to reverse its prior administrative construction of the statute, it appears from

the opinion of the lower court, 60 F. Supp. 979, that the taxpayer sold eighty-four notes, varying in denomination from $100,000 to $1,000,000, thirteen of said notes payable to the order of designated persons, seventy-one payable to bearer. All were negotiable. In assessing a stamp tax, the Commissioner relied primarily on the *appearance* of the notes and regarded them as being issued in *registered form.* The case was tried on stipulated facts, and no testimony was offered or received as to the proper classification of the notes, 60 F. Supp. at 981. The appellate court held that the instruments in question were debentures, reversing the trial court's judgment in favor of the taxpayer.

The instruments in the *General Motors* case are distinguishable on the facts for the following reasons: (1) *Appearance.* The *General Motors* notes were tinted, engraved, bore serial numbers and the corporate seal, and otherwise, so far as appearance was concerned, bore every evidence of the ordinary corporate bond, debenture or other corporate security. These factors do not exist with respect to the Leslie notes. (2) *Terms.* The notes were negotiable as is customary with bonds or debentures, and were not in the nature of a simple contract to borrow and lend money as is true in the instant case. (3) *Mode of Sale.* Unfortunately, the facts are incomplete in this respect as reported in the two opinions. These omissions, however, are cured by reference to the case of *Belden Mfg. Co. v. Jarecki,* 192 F.2d 211 (7th Cir. 1951), which discusses the record in *General Motors* which had been received in evidence. It appears that the sequence of events was first to print and engrave the notes, and sec-

and to offer the same for sale to the highest bidder in the investment public. The above sequence is that typically employed in the marketing of bonds, debentures or other corporate securities. By contrast, the loans in the instant case were negotiated from beginning to end with only the two lending institutions which ultimately made the loans; terms were discussed before being reduced to writing, and the loan contracts, as ultimately executed, were the result of *prior* negotiations, not instruments which the borrower first executed, then sold to the highest bidder from the investing public.

In assessing the correctness of the *General Motors* case, it appears to the undersigned that the result is not wholly in error, since many features of the transaction were similar to debenture financing. Our objection goes to certain unfortunate statements contained in the opinion, which statements have since been repudiated by the same court in *Niles-Bement-Pond Co. v. Fitzpatrick, supra.* Our first objection to the language of the *General Motors* case goes to the attempt by the court (131 F.2d at 596) to draw a distinction between what it calls "ordinary commercial promissory notes", apparently of a short time credit character, and notes which fall "into the category of debentures, as that term is used in the statute in its setting with bonds, and certificates of indebtedness, to designate a type of corporate securities which does not include ordinary promissory notes." There is, of course, no statutory justification for drawing such a distinction, and the court was consequently unable to point to any language of the present or prior statutes to support its conclusion. Further, the court's position was at variance

with the administrative construction of the statute in the light of its history in that previously no notes were taxed, whatever the amount and duration, unless bearing coupons or, in registered form, a fact which apparently was not called to the court's attention.

The court also stated that the method of sale to a few investors who indicated their then intention not to resell was a key factor in throwing the notes in question into the same general category as debentures and other corporate securities rather than in the category of ordinary promissory notes. It seems likely that the court fell into this latter error due to the fact that the taxpayer failed to offer any testimony as to how the instruments in question should be classified. With only the instruments before it, the appellate court failed to realize that bonds and debentures are prepared in a form to permit constant selling and reselling if so desired and that, if anything, an intention not to transfer is at variance with existence of the taxable, marketable instruments which are designed to permit transfer.

The court in the *General Motors* case went on to discuss whether the absence of registration or attached coupons had any significance. It noted that Congress added a provision to the statute in 1918 (40 Stat. 1057) taxing "instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities." The court concluded that it was "obvious" that this addition was to catch additional instruments not formerly taxable rather than to limit the taxation of debentures to a debenture which also bore interest coupons or was issued in registered form.

This reasoning is relatively unobjectionable so far as it goes, but the court fell into error by reason of its failure to further pursue its analysis. What "instruments however termed" were meant by the statutory addition? The answer that immediately comes to mind is a promissory note which does not purport to be a debenture, a bond, or a certificate of indebtedness, but which *is* issued with interest coupons or in registered form. As discussed in greater detail earlier in this brief, for a period in excess of twenty years this construction of the term "all instruments" was that given by the Treasury—the only *notes* taxed were those issued with coupons or in registered form; all others were not taxed. See the ruling contained in M. T. 32, Cum. Bull. 1948-2, p. 160, reversing the prior interpretation. In thus expanding the classification of taxable notes beyond those encompassed in the phrase "all instruments," the Second Circuit thus rendered nugatory the entire statutory provision it purported to construe.

It is not necessary for an affirmance here that this Court reject the holding in the *General Motors* case that the 1918 amendment to the statute did not mean that a "debenture" had to be in registered form or with attached coupons before it was taxable, although, as we have earlier pointed out, the legislative and administrative history indicates that this holding is wrong. We submit, however, that at the very least the implication of the amendment, as the Bureau of Internal Revenue previously held, is that however complicated and elaborate be the protective features accompanying a promissory note, it is still not subject to tax unless it also is in

registered form or with attached coupons. The Leslie notes are not in registered form nor do they have attached coupons (R. 31), and are consequently not taxable.

When the same court got a second chance to pass on the same question in *Niles-Bement-Pond Co. v. Fitzpatrick,* 213 F.2d 305 (2d Cir. 1954), the court, in an opinion by Judge (now Mr. Justice) Harlan, distinguished its earlier opinion in the *General Motors* case, repudiated its earlier view that the only promissory notes exempt from tax were those "used customarily in day to day commercial transactions of a short time credit character" and, by placing the emphasis on marketability as the typical characteristic of a debenture, also implicitly repudiated its earlier view that an intention not to transfer pushed an instrument into the classification of debentures rather than the converse.

The *Niles* opinion also distinguished the *GMAC* notes on the grounds of their different means of sale, the fact there was no negotiation between borrower and lender as to the *terms* of the note but merely as to their *price.* The same distinction also exists on the present facts, as does a third relied on by the Second Circuit—the fact that none of the notes before it in contrast to certain of the *GMAC* notes were made payable to bearer.

As to the other appellate decisions, none have been in favor of the Government except *Commercial Credit Co. v. Hofferbert,* 188 F.2d 574 (4th Cir. 1951), a per curiam affirmance of a trial court's opinion in 93 F. Supp. 562 (D.C. Md. 1950). Since the case blindly follows the GMAC

decision without independent analysis, it is entitled to no weight here.

By contrast, in addition to the *Niles* case we also find the following appellate decisions in the *Leslie* group: *Belden Mfg. Co. v. Jarecki*, 192 F.2d 211 (7th Cir. 1951); *Allen v. Atlanta Metallic Casket Co.*, 197 F.2d 460 (5th Cir. 1952); *United States v. Ely & Walker Dry Goods Co.*, 201 F.2d 584 (8th Cir. 1953); and *Curtis Publishing Co. v. Smith*, 220 F.2d 748 (3d Cir. 1955), petition for writ of certiorari filed July 22, 1955, No. 254, this Term.

Although contending that all of the above cases are wrong, the United States also claims that they may be distinguished. The fact is, however, that in each instance large scale and long duration loans were involved accompanied by elaborate protective agreements—in short, the very factors relied on in the attempt to justify a tax in the present case. It is true that in some instances one or more of the courts involved mention minor factual distinctions between the cases in question and the facts of the Leslie case. It is submitted, however, that none of these distinctions survive analysis with respect to the Government's claim that the Leslie case is weaker for the taxpayer than the other cases. The mention of such distinctions, where it occurs, may be explained, we submit, solely on two grounds, viz., industriousness of counsel in other cases in urging every conceivable factual distinction whether or not of true significance, and the understandable reluctance of the judiciary to state in so many words that the language of the *General Motors* case and the result of the *Commercial Credit* case are wrong.

More specifically, petitioner contends that the *Niles* decision holds that the *GMAC* decision involved marketable notes in that there was a provision providing for notes of a smaller denomination to be substituted for the existing obligations. How persuasive this distinction may have been to the Second Circuit in reaching its result in the *Niles* case we do not purport to know. We do know that the court was careful to state in the *Niles* case that a *combination* of factors, which does not exist in the Leslie case, was responsible for its ruling in the *General Motors* decision rather than any single factor. Further, in the instant case, as we earlier pointed out, the provision for substitution of debentures for the existing notes merely points up the fact that two informed lenders regarded the instant notes as so clearly non-marketable—regardless of Leslie's standing in the financial community—that they recognized that if marketability were to be achieved under any circumstances entirely new instruments would have to be executed. Such new instruments would be taxable. That does not make the old notes taxable unless this Court is prepared to hold, as petitioner apparently urges, that a tax should be imposed on the basis of hypothetical instruments which may or may not be issued in the future rather than those that were actually issued.

Petitioner further points out that the lender in the *Niles* case was a bank, insurance companies in the present case. However, the terms of loans, in all material respects similar to those now involved, are the same whether the lender be an insurance company or a bank according to the undisputed evidence in this case (R. 62-

64). Sometimes, in fact, a bank and an insurance company participate in the same transaction, the bank holding the earlier maturities and the insurance company the later (R. 64). That this is a common practice is confirmed by the article entitled "Term Lending to Business by Commercial Banks in 1946" by Duncan McC. Holthaus then on the staff of the Board of Governors of the Federal Reserve System, reported in the *Federal Reserve Bulletin* of May, 1947 (p. 500).

Petitioner also contends that the *Niles* loan was not for investment and the Leslie loans were. It is true that Mr. Justice Harlan referred to purchase of an "investment" and "investment securities" in writing the *Niles* decision. As we read the decision, however, the quoted words must be understood in the banking context of the case. For by statute the "investment" department of a national bank is restricted to the purchase of "investment securities," which must be marketable. Banking Act of 1933, 48 Stat. 162, Section 25, 12 U.S.C. §24 (1946). The Leslie notes do not qualify as such instruments. Thus, although in a sub-heading of the accompanying agreement (Pl. Ex. 3, Section 4, R. 45, 100) we find the phrase "Purchase for Investment," the words are used in a sense directly contrary to the banking sense in that it is apparent from the words immediately following that all the parties meant is that there was no present intention to resell. Indeed, great difficulty would lie due to the lack of marketability in reselling the Leslie notes whether or not there was included such a provision.

In the interests of brevity, we will not discuss the numerous district court cases in the present field, all of

which are cited in the petitioner's brief. However, in closing this portion of our discussion, we emphasize that the result of all appellate decisions below which are in any way persuasive is in accord with an affirmance here. The only factually similar case which was for the Government relied on unnecessarily expansive language in the *General Motors* case which is demonstrably erroneous, as recognized by the same court in a subsequent decision.

CONCLUSION.

For the reasons stated, the decision below should be affirmed.

Dated, San Francisco, California,
October 17, 1955.

Respectfully submitted,
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(Appendices A, B and C Follow.)